

Modification proposal:	The Provision of Multiple Storage Services within the Storage Services Contract ("SSC") (Modification Proposal Number 04)		
Decision:	The Authority ¹ has decided not to veto this modification proposal		
Target audience:	Centrica Storage Ltd ("CSL"), customers of CSL, storage operators and other interested parties		
Date of publication:	8 July 2008	Implementation Date:	8 July 2008

Background

On 14 November 2002, Centrica Storage Holdings Limited ("CSHL"), a wholly owned subsidiary of Centrica plc ("Centrica"), acquired the entire issued share capital of Dynegy Storage Limited and Dynegy Onshore Processing UK Limited.

The effect of the merger was to combine Centrica with two companies which owned and operated the Rough gas storage facility and associated assets. Rough is the largest gas storage facility in the UK.

On 25 February 2003, the resulting merger was referred to the Competition Commission (the "CC") under sections 64 and 69(2) of the Fair Trading Act 1973.

The CC's report concluded that the merger would increase the uncertainty faced by other industry participants and potential entrants and that, in the absence of further constraints, Centrica may have been expected to:

- discriminate between customers in giving access to capacity at Rough;
- use to its advantage sensitive information gained from the operation of Rough;
- withhold information about the operation of Rough;
- be less innovative in marketing Rough products than another owner; and
- invest less in expanding Rough's capacity than another owner.

As a result, the CC considered that competition in the markets for flexible gas and domestic gas supply would be weakened, that innovation and investment at Rough would be lower than under another owner and, therefore, that the merger may have been expected to operate against the public interest.

In order to remedy or prevent the adverse effects specified in its report, the CC requested a number of behavioural undertakings; such undertakings were given by Centrica plc and CSL² to the Secretary of State for Trade and Industry pursuant to Section 88 of the Fair Trading Act 1973 (the "undertakings").

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² CSL is Centrica's gas storage arm, a wholly owned subsidiary of CSHL.

Paragraph 2.4 of the undertakings provides that the terms of the Storage Services Contract ("SSC") under which CSL provides storage services to Customers cannot be altered unless:

- all Market Participants have been consulted on the proposed changes; and
- Ofgem agrees to the terms of the SSC.

Application to modify the SSC

On 9th June 2008 CSL submitted a proposal to Ofgem to modify the SSC. The purpose of the proposed modification is to facilitate the introduction of new types of storage services at the Rough storage facility, specifically "Day-ahead" (DA) storage services and services offering bundled entry capacity to the National Transmission System.

CSL states in its consultation document that this modification is proposed in response to requests from market participants, coupled with CSL's desire to innovate its suite of products. The inclusion of Throughput Capacity and the provision of multiple storage products in the SSC could lead to a greater amount of gas being stored and a greater amount of gas being landed onto the NTS, thus improving the certainty of the UK's storage and security of supply situation. This is because CSL will be providing choice in terms of the type of storage service any user is able to purchase.

CSL's consultation and Ofgem's decision

In accordance with paragraph 2.4(a) and Annex 1 of the undertakings, CSL has posted a consultation paper on the proposed changes on its website. In addition it held a workshop at which it gave the opportunity to market participants to ask questions and give feedback on the proposed changes.

The consultation closed on 6th June 2008, and CSL formally wrote to Ofgem on 9th June 2008 seeking its approval of the proposed changes. Ofgem has the right to veto the changes within one calendar month of receiving the written application.³

Ofgem has decided not to veto SSC Modification Proposal 04. The proposal introduces additional choice of products to CSL's customers (and potential customers). The C-store product ensures its users will not be affected by entry capacity constraints at the Easington entry terminal, as gas nominated for withdrawal during the Winter Period is delivered to the NBP. We consider this proposal to be consistent with one of the behaviours that the undertakings seek to encourage: to be innovative in marketing Rough products.

Some of the concerns raised by respondents suggest that the proposal may exacerbate two of the problems that the undertakings seek to address, namely that CSL can use to its advantage sensitive information gained from the operation of Rough, and can withhold information about the operation of Rough. In response to the concerns raised, we intend to closely monitor a number of aspects of the new products, and are looking to CSL to provide additional information to market participants on Rough capacity bookings and use, and further information to Ofgem to assist us to monitor the effect the new products have on the market.

³ See paragraph 4 of Annex 1 to the undertakings.

We consider that the benefits in terms of increased choice and innovation outweigh the potential detriments related to information and CSL trading.

Respondents' and Ofgem's views

CSL received four responses to its consultation. Two respondents raised no concerns with the new products. The other two respondents raised the following concerns:

One respondent suggested that customers holding C-store products should be allowed to choose whether or not to use their throughput capacity on any day in order to allow them to place locational bids and offers on the APX trading system.

Ofgem recognises that a CSL customer holding C-store capacity will not be able to place locational bids and offers on the APX. However, we note CSL's response that the majority of National Grid Gas (NGG)'s requirement for physical trades is driven by title trades, which are unaffected by the proposal, and NGG has stated that it does not have concerns over this issue. In addition, customers still have the choice to hold the standard (S-store) product, with which they will be able to respond to requests for locational bids and offers should they wish. Therefore Ofgem does not consider this to be a sufficiently material concern to prevent the introduction of the new storage products.

One respondent suggested that the maximum liability in respect of a breach of the agreement had been static for some time. The respondent suggested that the amount of £1,000,000 should be revised upwards.

As this comment is a general concern and does not relate to the modification proposal, Ofgem does not see it as a reason to veto the proposal.

One respondent offered the opinion that the introduction of Day Ahead (DA) services was not necessary to allay concerns raised by Rough customers regarding Easington capacity, and that their inflexible nature could result in gas being stranded offshore on a day.

Ofgem agrees that DA services are not necessary to allay concerns raised regarding capacity at Easington. We do however note that CSL outlines that these services are introduced "in response to the needs of our customers and requests from market participants" and hence not linked to the concerns over entry capacity.

We do note the risk that day-ahead customers are unable to react to within-day events, which could lead to gas being stranded offshore on a day. However, we would expect customers to price in this risk when choosing which storage product to purchase. The impact of this on market prices will depend partly on the level of take-up of the DA product, which Ofgem will monitor on an ongoing basis. We do not have concerns about security of supply in these circumstances, as long as CSL continues to operate robust use-it-or-lose-it arrangements for all of its capacity. Under paragraph 2.4(b) of the undertakings CSL must (and Centrica must ensure that CSL will) continue to operate use-it-or-lose-it arrangements in relation to all Rough capacity in line with the provisions contained in clause 14 of the SSC; and it would be fair to observe that CSL has supported use-it-or-lose-it principles. Moreover, since CSL retains the proceeds from interruptible capacity sales it has some incentive not to withhold from the market un-nominated withdrawal or injection capacity.

Nevertheless, Ofgem concludes that it would be helpful if CSL would provide a clear public-domain assurance (perhaps on its website) that it will make maximum practicable unused capacity (of any kind and source) available to the market.

In this respect, Ofgem notes that when CSL sets (day-ahead) the Daily Injection Adjustment Factors (DIAFs), it will not have final injection nominations from “DA” customers. Thus CSL may reasonably assume in setting the DIAF that the “DA” users will nominate the maximum injection they would be allowed, and thus they may find that additional firm injection capacity subsequently becomes available.

One respondent raised a concern over the potential for increased trading activity by CSL arising from providing the DA services and the potential information advantage held by CSL trading staff arising from the proximity to the operational staff.

As regards CSL’s trading activities, Ofgem notes that only one customer has expressed concern that the introduction of the new services might permit additional CSL trading activity, including the use of capacity not nominated by “DA” customers. However, Ofgem recognises that CSL potentially has access to increased levels of capacity and flexibility as a result of the introduction of a DA product. However, we do not see this as a concern in itself. There are clearly justifiable reasons for CSL to enter the trading market selectively. For example, it needs to procure gas for operational purposes – e.g. compressor operations, heating etc.

We recognise that the concerns raised, particularly with respect to information transparency, have the potential to impact market liquidity adversely. However, we do not consider that these concerns outweigh the benefits brought by the increased ability of Rough customers to bring gas onto the NTS without entry capacity constraints, and the increased choice available to the market.

In addition, Ofgem will continue to monitor CSL’s activity as part of its routine market surveillance activity; and in the event that CSL uses its privileged information or position inappropriately Ofgem would investigate, for example, under the Competition Act.

Additional information

In order to help address the transparency concerns, and to aid market participants in assessing how much additional capacity is available on each day, we would request CSL to increase the amount of information it publishes on products and capacity. Specifically:

- In respect of “before the day” information”, Ofgem asks CSL that when it chooses to publish in advance of a Storage Year information on the quantity or proportion of SBUs sold to date, then CSL should also publish the proportions (but not quantities) sold on the “Within-day” and “Day-ahead” basis. Also, whereas CSL currently publishes before each Storage Year the average price to be paid for SBUs, but not the exact quantity sold, Ofgem asks CSL to publish the proportions (but not quantities) sold on each basis, and the average price payable on each basis.
- Under clause 13 of the undertakings, CSL is obliged to publish information on Gross Nominations on at least 4 occasions each day. We would like to see the frequency of publication of this information increased to at least 8 times per day, and for one of those occasions to be as soon as possible after the close of day-ahead nominations (i.e. between 4am and 5am). We consider this to be consistent with the spirit of the undertakings, and it will help customers and other

market participants to form a view on evolving conditions in the market within the day.

Under clause 10 of the undertakings, CSL currently provides to Ofgem on a monthly basis details of all individual capacity sales. We will be formally requesting CSL to indicate under which of the four new products (S-store WD, S-store DA, C-store WD, C-store DA) each capacity sale is made.

For the avoidance of doubt, any decisions made or views expressed in relation to this application to modify the SSC do not preclude or impact in any way on the operation of the Competition Act 1998 or the Enterprise Act 2002. Further, as the arguments contained in this document are in relation to a specific situation, they may or may not necessarily be relevant to a consideration of any related issues that may arise, for example under the Gas Act, the Competition Act 1998 or the Enterprise Act 2002.

In accordance with paragraph 4 of Annex 1 the Undertakings Ofgem has decided not to exercise its veto over the proposed changes to the SSC.

If you would like to discuss this further please contact Ben Woodside on 020 7901 7471.

Yours sincerely,



Kersti Berge
Head of GB Markets